

Message Text

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PAGE 01 BRASIL 03152 131226Z

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ACTION ARA-10

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SUBJECT: AUTHORITIES INCREASE RESERVE REQUIREMENTS TOGETHER
WITH OTHER MEASURES IN FIGHT AGAINST INFLATION

REF: BRASILIA 2293

1. SUMMARY: MONETARY AUTHORITIES RAISE RESERVE
REQUIREMENTS AND APPROVE MEASURES TO IMPROVE OPERATION
OF "OPEN MARKET" AS EFFORTS TO FIGHT INFLATION CONTINUE.
INFLATION IN MARCH SHOWED LITTLE SIGN OF ABATEMENT.
END SUMMARY.

2. AFTER RAISING THE DISCOUNT RATE LAST MONTH (REFTEL),
THE MONETARY AUTHORITIES HAVE NOW ANNOUNCED AN INCREASE
FROM 27 PERCENT TO 33 PERCENT IN COMPULSORY RESERVE
REQUIREMENTS AGAINST DEMAND DEPOSITS WITH BANKS IN
CENTRAL-SOUTH REGION (WHICH HOLD THE BULK OF DEMAND
DEPOSITS IN BRAZIL). IN A PARALLEL ACTION, THEY ALSO
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PAGE 02 BRASIL 03152 131226Z

FREED INTEREST RATES CHARGED BY COMMERCIAL BANKS ON

PERSONAL LOANS (LAST MONTH THEY HAD FREED THE RATES CHARGED BY INVESTMENT BANKS AND FINANCE COMPANIES) AND INCREASED THE RATE ON SHORT-TERM COMMERCIAL LOANS TO 1.6 PERCENT PER MONTH (UP FROM 1.3 PERCENT). COMMERCIAL LOANS OF OVER 12 MONTHS WILL CONTINUE TO CARRY A RATE OF 1.8 PERCENT PER MONTH.

3. TOGETHER WITH THESE ACTIONS, THE MONETARY COUNCIL ALSO APPROVED A NUMBER OF MEASURES DESIGNED TO CORRECT MANY OF THE PROBLEMS AND DISTORTIONS WHICH HAVE BEEN DISTURBING THE OPERATION OF THE "OPEN MARKET" IN RECENT MONTHS. SUCH DISTURBANCES HAVE BEEN ATTRIBUTABLE TO EXCESSIVE USE OF REPURCHASE AGREEMENTS BY FINANCIAL INSTITUTIONS IN THE SALE OF FIXED INTEREST SECURITIES. FINANCIAL INSTITUTIONS HAD BEEN USING, IN RECENT MONTHS, REPURCHASE AGREEMENTS WITH A GUARANTEED INTEREST RATE AND A FIXED REPURCHASE DATE TO SELL NOT ONLY TREASURY BONDS AND BILLS BUT ALSO OTHER FIXED INTEREST ASSETS SUCH AS CERTIFICATES OF DEPOSIT, BILLS OF EXCHANGE, AND STATE BONDS. THE NET EFFECT OF SUCH A POLICY WAS TO CREATE A WHOLE NEW SERIES OF QUASI-MONEY, MAKING IT EXTREMELY DIFFICULT FOR THE MONETARY AUTHORITIES TO CONTROL LIQUIDITY IN THE ECONOMY. UNDER THE NEW REGIME, REPURCHASE AGREEMENTS WITH A GUARANTEED INTEREST RATE, ENTERED INTO BY FINANCIAL INSTITUTIONS WITH THE PUBLIC, HAVE BEEN LIMITED TO THE SALE OF TREASURY BILLS (LTNS). REPURCHASE AGREEMENTS BETWEEN FINANCIAL INSTITUTIONS, WHICH REPRESENT MERELY A SHIFT IN RESERVES FROM ONE INSTITUTION TO ANOTHER, CAN CONTINUE TO BE MADE AT A GUARANTEED RATE AND A FIXED DATE. (FURTHER DETAILS OF THESE MEASURES WILL BE SUMMARIZED IN SEPARATE AIRGRAM).

COMMENT:

4. THESE LATEST POLICY MEASURES PROVIDE NOT ONLY ADDITIONAL EVIDENCE OF OFFICIAL CONCERN WITH INFLATIONARY TRENDS BUT ALSO A DETERMINATION TO TAKE LIMITED OFFICIAL USE

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PAGE 03 BRASIL 03152 131226Z

THE NECESSARY STEPS TO FIGHT IT. INFLATION IN MARCH SHOWED ONLY MODEST SIGN OF ABATEMENT. THE GENERAL VICE INDEX, THE BELL-WEATHER OF INFLATION, WENT UP BY 3.7 PERCENT, AS AGAINST 4.2 PERCENT IN FEBRUARY (AND ABOVE THE 3.0 PERCENT PREDICTED BY THE FINANCE MINISTER). FOR THE FIRST QUARTER, THIS INDEX SHOWED A RISE OF 11.3 PERCENT, AS COMPARED WITH 6.2 PERCENT DURING THE COMPARABLE PERIOD LAST YEAR. DURING

THE LAST 12 MONTHS, THE INCREASE HAS BEEN 35.6 PERCENT.

5. A BASIC CAUSE OF INFLATION IN BRAZIL IN RECENT YEARS HAS BEEN, AND CONTINUES TO BE, EXCESSIVE CREDIT EXPANSION THROUGH THE COMMERCIAL BANKS. THE FACT THAT THIS INFLATIONARY THRUST IS NOT YET UNDER CONTROL WAS REVEALED BY FINANCE MINISTER SIMONSEN WHEN HE ANNOUNCED THAT AT THE END OF MARCH COMMERCIAL BANK CREDIT WAS ABOUT CR\$6.8 BILLION (ABOUT US\$712 MILLION) ABOVE THE EXPANSION PROJECTED IN THE MONETARY BUDGET. THE LATEST INCREASE IN RESERVE REQUIREMENTS TOGETHER WITH MORE RIGID RULES CONTROLLING THE OPEN MARKET SHOULD BRING THE CREDIT SITUATION UNDER BETTER CONTROL OF THE MONETARY AUTHORITIES. CRIMMINS

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